



UHERO FORECAST PROJECT

KAUAI ECONOMIC OUTLOOK SUMMARY

PREPARED FOR THE COUNTY OF KAUAI

KAUAI RECOVERY TO BROADEN BEYOND TOURISM

JUNE 20, 2014





UHERO

THE ECONOMIC RESEARCH ORGANIZATION
AT THE UNIVERSITY OF HAWAII

KAUAI ECONOMIC OUTLOOK SUMMARY PREPARED FOR THE COUNTY OF KAUAI

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EXECUTIVE SUMMARY

The visitor industry has been the leading light in Kauai's recovery from the 2008-2009 recession. Now that tourism growth is tapering off, construction and other sectors will play a more important role in the continuing expansion. The employment picture has improved considerably, and significant income gains are on the way.

- Visitor days set a new record last year. A 7% growth in room rates and an increase in length of stay helped boost overall visitor spending on Kauai by nearly 13%.
- Arrivals from the dominant US market have been progressively weakening since the first quarter of 2013, and annual numbers for this year will suffer as a result. Next year, arrivals growth will pick up to 3.6%, as US demand firms.
- Last year, Kauai's unemployment rate stood at 5.7%, but jobs have only returned to pre-recession levels in a limited number of sectors, including leisure and hospitality and healthcare.
- Kauai's construction sector has turned the corner, but remains depressed. The industry will begin to add jobs at an accelerating rate, peaking at 11% in 2016.
- Overall, the job base will expand by 2% this year, with similar rates of growth for the next several years. Expansion will be more broad-based than in recent years.
- After last year's 2.1% expansion, inflation-adjusted personal income growth will shift into the 3.5% range this year and next as business conditions improve.

KAUAI MAJOR ECONOMIC INDICATORS
YEAR-OVER-YEAR % CHANGE

	2011	2012	2013	2014	2015	2016
Visitor Arrivals	4.8	7.2	2.7	1.7	3.6	2.6
U.S. Visitor Arrivals	4.8	6.4	1.5	1.9	3.5	2.8
Japan Visitor Arrivals	10.4	18.4	5.3	-4.6	1.1	1.7
Other Visitor Arrivals	4.2	9.9	8.6	2.0	4.4	1.7
Payroll Jobs	0.4	1.6	2.5	2.0	1.6	2.2
Inflation Rate, Honolulu MSA (%)	3.7	2.4	1.8	1.7	3.1	4.3
Real Personal Income	2.4	0.6	2.1	3.5	3.6	3.4

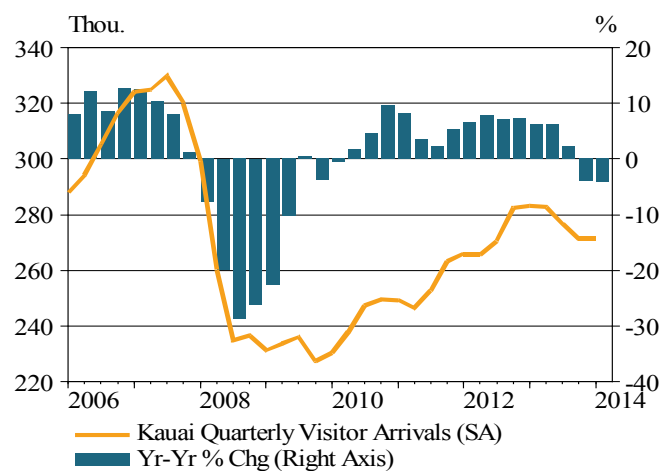
Figures for 2014 - 2016 are forecasts.

Figures for 2013 income are UHERO estimates.

Kauai's economic recovery accelerated last year. Visitor industry gains, while off 2012's robust pace, were the strongest among the Neighbor Islands, and job growth was solid. Visitor industry activity has fallen off recently, and the scope for additional gains will be limited going forward. While construction continues to languish, we expect marked improvement over the next several years.

After rapid expansion in 2012, the visitor industry saw more measured growth in 2013. Direct air seats to the state increased 5.6%, and there was a more modest 1.4% uptick in seats on direct flights to Kauai. A new direct route from San Diego and increased service from several cities in the Pacific Northwest added lift to Lihue, but these gains were largely offset by reduced service from Oakland and San Jose. While the number of direct air seats to Lihue from North America has doubled over the past decade, many visitors still fly to Kauai on inter-island routes. In total more than 1.1 million tourists visited the Garden Isle last year, a 2.7% increase from the previous year. Arrivals remained 14% below the all-time record set in 2007, but this is misleading since arrivals figures for the mid-2000s were inflated by the large number of short-staying cruise visitors at that time. Total visitor days, which takes into account both the number of visitors and their average length of stay, increased 4% last year, setting a new record.

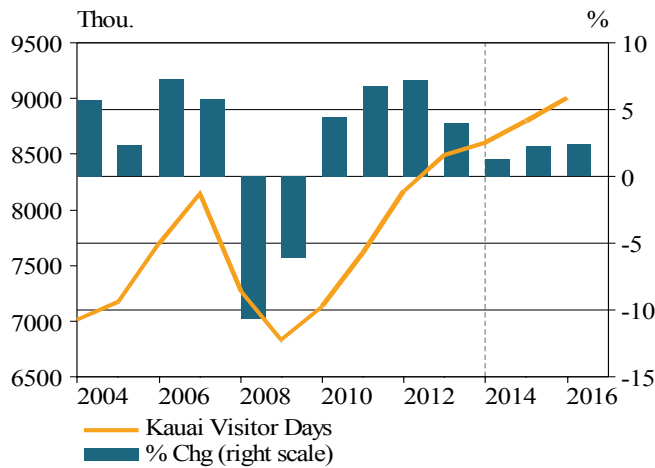
Kauai visitor arrivals exhibited sizeable variation across markets last year. US arrivals edged up only 1.5%, while arrivals from international markets increased 8.2%. Of the four counties, Kauai's visitor industry is the most dependent on the US mainland market. As a result, it is especially susceptible to a slowdown in US visitor traffic. Arrivals from Japan saw moderate growth, but these visitors represent a very small market on Kauai, accounting for fewer than 3% of all arrivals. Visitors from international markets other than Japan — primarily Canada, China, South Korea, Australia, and New Zealand — rose 8.6%.



LAST YEAR'S ANNUAL VISITOR FIGURES MASK A MARKED SLOWING OF THE INDUSTRY OVER THE COURSE OF THE YEAR

Kauai and the rest of the Neighbor Island counties saw increases in length of stay last year, while many visitors opted for shorter stays on Oahu. At least in part, this reflects capacity constraints that are beginning to bite on Oahu. Hotel occupancy rates in Honolulu County are near historical highs, while there remains spare capacity on Kauai. Last year, the average hotel occupancy rate on Kauai was about 69%, up about a half-percent from the previous year, but still below the 75-78% range seen before the recession. And room rates on Kauai have experienced more limited appreciation than on Oahu. The average hotel room rate on Kauai has risen by 20% over the past three years, compared with a 40% surge on Oahu. Last year, room rates on Kauai averaged \$226 per night, up 7% from the previous year. Higher room rates and record visitor days helped to boost overall visitor spending on Kauai by nearly 13%. (Data is from Hospitality Advisors LLC.)

Last year's positive annual figures mask a marked slowing of the visitor industry over the course of the year. After strong growth in the first three months, arrivals slowed during the second and third quarters, and they fell 2.3% year-over-year in the fourth quarter. The end-of-year decline resulted from a weakening US market, which was only partly offset by rising international arrivals.



WITH VISITOR DAYS AT RECORD LEVELS,
FURTHER GAINS WILL BE LIMITED

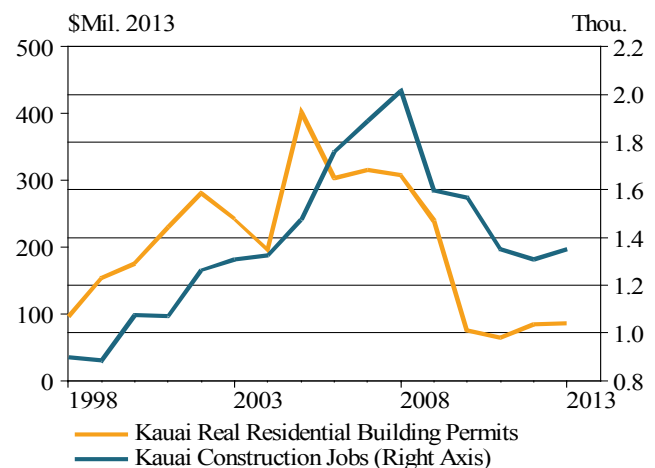
Through April 2014, US arrivals are down nearly 3%. Visitors from international markets other than Japan, which have expanded strongly for several years, are up just 3%. Prospects look better for the summer, based in part on healthy growth in scheduled airline seats, which are up more than 15% for the June-August period. For the year as a whole, we expect US and international arrivals to rise about 1.8% and 1%, respectively.

Overall, we expect 1.7% growth in visitor arrivals to Kauai this year, down from last year's 2.7% gain. Next year will see a stronger 3.6% rise, because of healthier US demand and increased airlift. Like other Neighbor Island counties, Kauai has sufficient room stock in the near term to accommodate more visitors. Arrivals growth rates will trend downward thereafter. With occupancy rates rising to levels typical of previous periods of healthy tourism performance, and few anticipated additions to the room stock, the scope for additional visitor growth is limited.

The Kauai construction industry finally turned the corner last year, after four years of significant job losses. However, permitting for new construction remains at an exceptionally low level. The value of residential permits issued last year was just 28% of their level in 2006. (Data on

nonresidential permits are not available for Kauai county.) On the plus side, resales of existing homes have risen 70% from their low point in 2009, and median single-family home prices rose 13% last year. The firming of the housing market will provide increasing incentives for new building going forward. After a 3.5% job growth this year, we expect growth in construction jobs to rise to 5% next year, and to 11% in 2016. This will push the level of construction employment on Kauai above the level seen in 2005, when the last housing upswing was building in earnest. (UHERO produces a detailed report on the state construction industry. A summary of the most recent report, *Construction Upturn on Track*, can be found at www.uhero.hawaii.edu.)

In the energy sector, Kauai's electric utility, the Kauai Island Utility Cooperative (KIUC), continues to work towards its goal of 50% renewable energy generation by 2023. Currently, roughly 17% of the island's electricity is generated from a combination of hydroelectric and solar energy projects. Work is underway on a 12-megawatt solar energy project in Koloa, which is expected to be completed this summer. Work is expected to begin soon on a second 12-megawatt solar project in Anahola. Once completed, these two solar projects, together with an existing solar farm in Port Allen, are expected to generate a combined total of 30



CONSTRUCTION HAS TURNED THE CORNER, BUT
PERMITTING REMAINS EXCEPTIONALLY WEAK

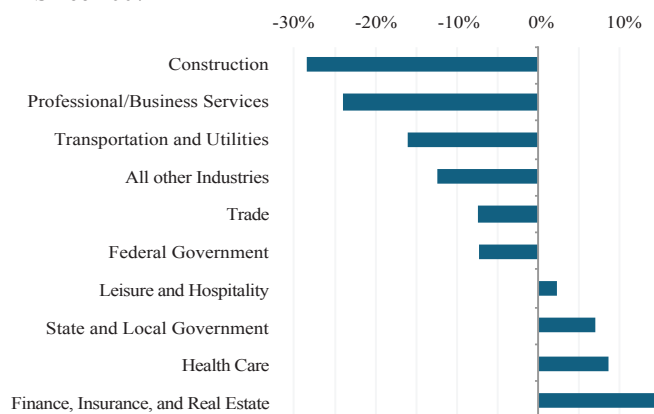
megawatts during the day, nearly half of the island's daytime electricity demand.

New figures from the 2012 USDA Census of Agriculture indicate that the Kauai agricultural industry has undergone a period of consolidation since the time of the last census in 2007. In 2012, there were 591 farms operating on Kauai, 157 fewer than there were in 2007. Despite fewer farms, the aggregate value of crop and livestock sales increased more than 40% to nearly \$64.5 million. Seed crops, primarily corn grown for seed, continue to play a large role in the local agricultural industry. The latest figures from the USDA indicate that, in the 2012-2013 crop year, the Hawaii seed industry produced a record-setting crop of more than 12.3 million pounds of seed. Because there are only ten seed crop farms operating in Hawaii, county-level data are not disclosed by the federal government.

At 5.7%, Kauai's unemployment rate remains elevated, but substantial progress has occurred since the rate peaked above 9% in 2009. The county experienced the largest decline in the unemployment rate across the state over the past four years. However, a large part of last year's drop continued to be the result of a shrinking labor force, as opposed to an increase in the number of people finding work. Figures for the first quarter of 2014 are more encouraging, showing some signs that the labor force is beginning to stabilize. While UHERO does not prepare separate unemployment forecasts for the Neighbor Islands, we do expect the problem of joblessness to recede further over the next several years.

As has been true throughout the recovery, the data on payroll jobs from the establishment survey have shown somewhat greater improvement than have the employment statistics from the household survey. Last year, the payroll job base rose 2.5%, the strongest performance of the recovery so far. Still, there is a ways to go before the labor market

Percentage Change in Jobs Since 2007

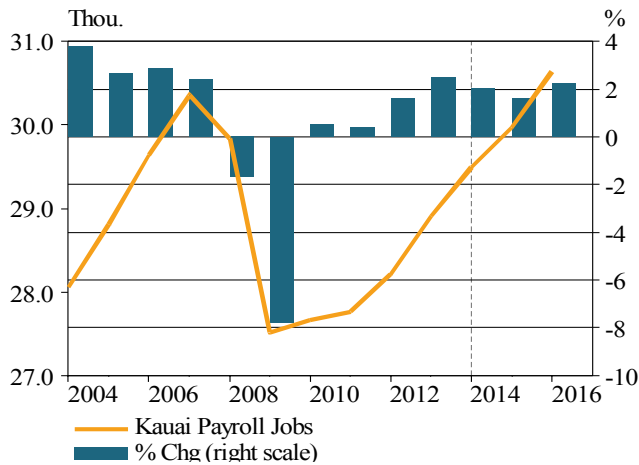


JOBS HAVE ONLY RETURNED TO PRE-RECESSION LEVELS IN A LIMITED NUMBER OF SECTORS

recovery on Kauai is complete; so far fewer than half the jobs lost since the 2007 peak have been regained.

Jobs have only returned to pre-recession levels in a limited number of sectors. The number of jobs in leisure and hospitality — a broad sector including service industries closely linked to tourism, such as accommodations, food service, and entertainment — has finally surpassed pre-recession levels, after increasing 4.2% last year. Healthcare jobs took only a minor hit during the recession because of the relatively steady growth of demand for healthcare services. They were up 3.9% to an all-time high last year. Real estate jobs are coming back, rising more than 14% last year. Finance and insurance jobs are also at an all-time high after recovering from a brief decline in 2010. Government jobs are at a record level, despite zero growth in 2013.

For most other sectors, there has been little progress in the recovery of jobs lost during the downturn. Employment in the trade sector has finally begun to pick up after five consecutive years of job losses, but the number of jobs remains far short of pre-recession levels. The professional and business services sector continued to shed jobs; since 2007 the number of jobs in the sector has fallen by almost 25%. Transportation and utility jobs also remain nearly 17% below



NONFARM PAYROLLS WILL AVERAGE ABOUT 2% GROWTH OVER THE NEXT SEVERAL YEARS

pre-recession levels. While it is unclear why hiring remains so weak across such a broad range of sectors, one potential explanation is the low level of activity in construction that we have discussed above. The construction industry has indirect impacts on spending and employment in many areas of the local economy, everything from architecture to warehousing to furniture sales. As building activity gradually picks up, this should help to support more broad-based improvement.

Preliminary figures indicate that non-farm payrolls are up just 1.3% on Kauai for the first four months of 2014. (These preliminary figures will undergo several, possibly significant, revisions before they are finalized.) This year, relatively strong growth will again be seen in accommodation and food services, and in trade. Federal job losses have ended for now, and state and local government hiring will improve. Overall, the job base will expand by 2% this year, with similar rates of growth for the next several years.

While county income figures for 2013 are not yet available, we estimate that inflation-adjusted personal income in Kauai County grew at a moderate 2.1% rate last year, despite the negative effect of the expiring payroll tax cut. The return of social security contributions to their pre-recession levels took a bite out of after-tax income last year. Labor income rose a healthy 2.8%. Relatively robust income growth in the 3.5% range will persist this year and next, as improving business conditions and ongoing employment growth drive gains in employee compensation.

Among large sectors, income growth will touch 4% in construction and exceed 4.5% in accommodation and food services this year. Greater than 2% growth will be seen in healthcare and the large “other services” sector. The aggregate income of state and local government workers will rise nearly 3%, reflecting both an expanding public sector workforce and modest increases in salaries. Federal government hiring on Kauai will also expand modestly, now that last year’s fiscal crisis is behind us. (Note that for confidentiality reasons, income figures are not reported for some sectors on Kauai where there are a limited number of firms reporting.)

Kauai’s economic recovery has built up some strength over the past three years, and growth will broaden beyond tourism. The employment picture has improved considerably, and significant income gains are on the way. Construction, which has lagged the rest of the state, has finally begun to edge upward. This will provide additional support for moderate growth over the next several years.

MAJOR ECONOMIC INDICATOR SUMMARY
KAUAI COUNTY FORECAST

	2011	2012	2013	2014	2015	2016
Non-farm Jobs (Thou)	27.8	28.2	28.9	29.5	30.0	30.6
% Change	0.4	1.6	2.5	2.0	1.6	2.2
Total Population (Thou)	67.7	68.4	69.5	70.2	70.9	71.6
% Change	0.8	1.0	1.6	1.0	1.0	1.0
Total Personal Income (Mil \$)	2,550.9	2,627.3	2,729.7	2,873.0	3,068.6	3,311.6
% Change	6.2	3.0	3.9	5.3	6.8	7.9
Inflation Rate, Honolulu MSA (%)	3.7	2.4	1.8	1.7	3.1	4.3
Real Personal Income (Mil 2013 \$)	2,658.8	2,674.2	2,729.7	2,824.8	2,927.0	3,027.3
% Change	2.4	0.6	2.1	3.5	3.6	3.4
Real Per Capita Income (Thou 2013 \$)	39.3	39.1	39.3	40.3	41.3	42.3
% Change	1.6	-0.4	0.4	2.5	2.6	2.4
TOURISM SECTOR DETAIL						
Total Visitor Arrivals by Air (Thou)	1,011.5	1,084.7	1,113.5	1,132.6	1,172.8	1,203.5
% Change	4.8	7.2	2.7	1.7	3.6	2.6
U.S. Visitors	837.9	892.0	905.1	922.0	953.8	980.8
% Change	4.8	6.4	1.5	1.9	3.5	2.8
Japanese Visitors	23.6	27.9	29.4	28.0	28.3	28.8
% Change	10.4	18.4	5.3	-4.6	1.1	1.7
Other Visitors	150.0	164.8	179.0	182.5	190.6	193.9
% Change	4.2	9.9	8.6	2.0	4.4	1.7
Avg. Length of Stay (Days)	7.5	7.5	7.6	7.6	7.5	7.5
Visitor Days (Thou)	7,617.3	8,170.5	8,496.9	8,606.9	8,799.8	9,007.7
% Change	6.8	7.3	4.0	1.3	2.2	2.4
Occupancy Rate (%)	63.9	68.8	69.1	71.9	71.7	72.7
Total Room Stock (Thou)	9.9	10.1	10.1	10.1	10.1	10.1
% Change	5.7	2.0	0.2	0.0	0.0	0.2

Note: Source is UHERO. Figures for 2014 - 2016 are forecasts.

Figures for 2013 income are UHERO estimates. Figures for 2012 and 2013 room stock are UHERO estimates.